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UNCLAS SECTION 01 OF 03 KINGSTON 000903

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STATE FOR WHA/CAR (RBUDEN), WHA/EPSC (JSLATTERY)

SANTO DOMINGO FOR FCS AND FAS

TREASURY FOR A FAIBISHENKO

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TAGS: [ECON](#) [EFIN](#) [EIND](#) [CPAS](#) [JM](#) [XL](#)

SUBJECT: JAMAICAN ECONOMY SLUGGISH IN FIRST QUARTER

REF: A. 06 KINGSTON 1286

[1](#)B. KINGSTON 705

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SUMMARY  
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[1](#)1. The Jamaican economy expanded by two percent during January to March 2007. Growth was driven by agriculture and construction, as tourism output declined for the first time in four years, following the return of Cancun after hurricane damage. Inflation of one percent was the major success story of the Jamaican economy during the first quarter. The foreign exchange market suffered bouts of instability because of increased liquidity and lower capital inflows, but strategic intervention by the central bank minimized the level of depreciation. Fiscal policy remained the biggest challenge facing the country, with the GoJ missing all of its fiscal targets and having to defer some expenditure items to minimize the fallout. Going forward, growth will remain sluggish as tourism wanes, but the productive sector should post reasonable growth. With commodity prices on the rise, inflation could accelerate, while the foreign exchange market could face demand pressure as investors switch to foreign assets in the face of uncertainty. But it is fiscal policy which will pose the greatest threat, and any deviation in the fiscal target could lead to a downgrading of the country's credit ratings. End summary.

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Growth Stagnant  
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[1](#)2. The Jamaican economy started 2007 on a low, with output growth for the first quarter lagging behind its three percent target. Real GDP for the March quarter is estimated to have grown by only two percent, due to flat services and more specifically tourism output. However, the productive sector jumped by 2.8 percent, reflecting renewed buoyancy in construction activity following the regularization of cement supplies. The robust growth in construction is a normalization of the growth rates observed prior to the 2005 cement shortage (ref. A) and continues to be driven by massive hotel and infrastructural projects. Agriculture expanded by four percent, by far the lowest rate of growth in five quarters, suggesting the sector has returned to pre-hurricane growth levels. Manufacturing, which continued its downward trajectory (0.2 percent), has established itself as the chronically weak sector of the Jamaican economy. Unlike agriculture, which benefits from high levels of protection and has well-established links (especially with tourism), the manufacturing sector has been unable to forge the linkages necessary for survival. This is largely attributable to declining competitiveness following trade liberalization in the

1990s.

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Star Performer Wanes  
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¶3. After enjoying four years of uninterrupted growth, tourism services declined by almost one percent during January to March ¶2007. This is significant as the tourism sector had become the mainstay of the Jamaican economy, growing by as much as 20 percent in the second quarter of 2006. For the first quarter total visitor arrivals fell by 0.5 percent to 838,874, while total earnings declined by 0.2 percent to USD 475.7 million. Stop-over arrivals (overnight) for the same period were 436,562, a decline of 2.1 percent relative to the similar period of 2006. Lower arrivals from the United States, down 12.1 percent, were largely responsible for the fall off in the sector. Increased arrivals from Canada and Europe mitigated the overall statistics.

¶4. The break in the growth trajectory is disturbing to tourism officials, who have blamed the Western Hemisphere Travel Initiative and the introduction of a temporary CARICOM Visa for Cricket World Cup (CWC) 2007. However, the current performance must also be analyzed within the context of exceptional arrivals in 2006; in particular, there was a diversion of visitors to Jamaica as a result of hurricane damage to Cancun. But with that destination back to normal and engaging in an aggressive promotional campaign, the positive shock has dissipated. In fact, arrivals for the first quarter of 2007 are still ahead of arrivals for the similar period of 2005 and if the country had not benefited from Cancun's misfortune in 2006, the growth momentum would have continued into ¶2007. GoJ officials also posit that the anticipated crowds for CWC (which did not materialize) and a CWC-related public announcement issued by the USG also may have scared some visitors away from the island.

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Fiscal Operations a Drag on Growth  
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¶5. Fiscal operations continued to be the Achilles heel of the Jamaican economy and could well be the underlying cause of the country's economic malaise. During January to March 2007 GoJ operations generated a surplus of USD 13.2 million, well below the targeted surplus of USD 181 million. The deviation from target was due to a combination of lower-than-expected revenues and higher spending. But this result is not surprising, given that the revenue target was overly ambitious in the context of sluggish economic growth and moderate price increases. It was also going to be difficult to contain spending in general - and salaries in particular - in the period leading up to an election. In fact, members of the essential services (e.g., police, nurses, teachers, and firemen), who make up the bulk of the public sector, were able to bargain for much more than the amount offered to the rest of the public sector.

¶6. Against this background, GoJ operations for the full fiscal year generated a deficit of 5.3 percent of GDP, more than twice the projected deficit of 2.5 percent of GDP. In addition to reversing the downward trend observed since the 2003/04 fiscal year, the fiscal result also forced the GoJ to again postpone its balanced budget target to 2009/2010. But the fiscal position would have been worse if the GoJ had not deferred spending of 2.5 percent of GDP to the current fiscal year, confirming that the practice of deferred financing, exposed by the Opposition and disparaged by the IMF, remains intact. Senior Director at the Ministry of Finance and Planning Courtney Williams told emboff that, in the absence of shocks to explain the significant deviation, he was surprised that the country's credit ratings had not been downgraded. But, credit ratings aside, a rising deficit only adds to the burgeoning debt, putting a further drag on growth, while forcing the central bank to defer the interest rate reduction strategy necessary to stimulate output growth. Therefore, any continuation of fiscal looseness will only cement the country's place among the economic laggards of the

developing world.

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Prices Stable, But Demand Pressures Emerge  
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¶7. The moderation in prices was the major success story for the first quarter. Inflation for the period was one percent, bringing the rate for the fiscal year to 6.6 percent, the lowest rate since 2002/2003. First quarter inflation reflected increases in healthcare and personal expenses, fuels, housing and housing expenses, and food and drink. Amidst the moderation in prices, there were renewed bouts of instability in the foreign exchange market. Demand pressure was largely influenced by high levels of Jamaican dollar liquidity and declining net capital inflows, as tourism earnings moderated and the trade balance deteriorated. The central bank also confirmed that there was no evidence of the much anticipated inflows from CWC 2007. Despite the instability, the exchange rate depreciated by less than one percent as the central bank intervened in the market by selling foreign exchange from the Net International Reserves (NIR) to smooth supplies. Notwithstanding, the stock of NIR remained robust at USD 2.33 billion.

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Comment  
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¶8. The Planning Institute of Jamaica is projecting growth of 2.1 percent for the second quarter of 2007, led by continued expansion in the productive sector. Agriculture, construction, and mining are expected to lead the way. Tourism arrivals will continue to lag behind 2006 levels, as Cancun regains lost ground. With the rate of economic expansion expected to remain constant, the economy will have to grow faster in the second half of 2007 to meet the three percent target. But with the hurricane season and general elections approaching and with international commodity prices rising, it is unlikely that growth will pick up. In fact, prices increased in April 2007 by 0.7 percent, the highest monthly increase since September. Despite the surge in oil and grain prices, barring shocks, inflation for 2007 should fall within the 7-8 percent range.

¶9. The local currency could face increasing pressure once elections are announced, as Jamaicans switch to foreign assets during the period of uncertainty. This could force the central bank to use an

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increasing portion of its NIR to protect the currency against a steep depreciation. But it is fiscal policy which will pose the greatest threat going forward. The GoJ was originally targeting a fiscal deficit of 4.5 percent of GDP for fiscal year 2007/08, but unbudgeted spending, like the removal of health fees for children under 18 (ref. B), could push this figure over five percent. Apart from increasing the country's massive debt level, the increased borrowing could also stall the central bank's interest rate reduction program. This is disconcerting, as any major deviation in the fiscal target could erode credibility, leading to a downgrade in the country's credit ratings. The party forming the next government will therefore have the monumental task of making the hard decisions necessary to stabilize the country, and the attendant risk of being a one-term government. End comment.

JOHNSON